



COUNCILMEMBER DONNA FRYE

City of San Diego
Sixth District

MEMORANDUM

DATE: November 2, 2007
TO: Mayor Jerry Sanders
City Attorney Michael Aguirre
FROM: Councilmember Donna Frye
SUBJECT: IRS Determination on DROP

Donna Frye

To the best of my knowledge, the Internal Revenue Service (IRS) has not yet been requested to provide a determination on whether the DROP program complies with the Internal Revenue Code (IRC), and it appears that the San Diego City Employees Retirement System (SDCERS) does not plan to ask the IRS whether or not the DROP benefits are in compliance with the IRC.

For some background, the San Diego Municipal Code requires compliance with applicable provisions of the IRC. Section 24.1408 (a) states in part that: "*DROP is not intended to jeopardize the tax-qualified status of the Retirement System under the rules and regulations of the Internal Revenue Service.*" Section 24.108 (b) states in part: "*...benefits provided under this Division are subject to the requirements of the Internal Revenue Code and regulations issued thereunder for the Retirement System to remain a tax-qualified retirement plan...*"

On July 14, 2006, the IRS sent a letter to SDCERS tax counsel, Ice Miller, suggesting that SDCERS obtain a private letter ruling regarding the DROP benefits. The IRS sent another letter to Ice Miller on February 13, 2007, with the same suggestion.

On March 14, 2007, Ice Miller stated in a letter to the IRS that they would not request the IRS private letter ruling with respect to DROP.

On October 8, 2007, I sent a memo to SDCERS asking for a copy of any IRS documentation to show that DROP was legal. Their October 29th response stated in part that, "*SDCERS has not applied for an IRS opinion regarding the legality of the City's DROP program, nor is DROP's legality at issue in our ongoing VCP process*" suggesting my request was "*probably more appropriately addressed to the City's lawyers, not SDCERS.*"

SDCERS then stated that, *"We are not aware of any IRS opinion questioning the legality of DROP programs in general."* This fact is not relevant however, because SDCERS is fully aware that the City's DROP program is unique. As an example, the City's DROP program is, or at least was as of a few years ago, the only one in the nation that allows employees and the plan sponsor to make contributions to the DROP program. That the IRS may not have questioned the legality of different forms of DROP used by other government agencies is not an appropriate excuse to avoid seeking a private letter ruling on San Diego's unique version of DROP.

Because there are tax implications if it is found that the benefits granted under the DROP program are not in compliance with the IRC, it is my recommendation that the City of San Diego, as plan sponsor, take any and all steps necessary to ensure compliance with the IRC, including requesting a private letter ruling from the IRS regarding the DROP benefits.

Your prompt written response is requested and appreciated.

cc: City Councilmembers
Andrea Tevlin, Independent Budget Analyst
City Auditor and Comptroller
Macias Gini & O'Connell
Stanley Keller, Independent Consultant

DF/ks